DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 04-20050456
SALES AND USE TAX
FOR TAX YEAR 2003

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ISSUE

I. Sales Tax and Use Tax: Exemption

Authority: IC 6-8.1-5-1(b); IC 6-2.5-2-1; IC 6-2.5-5-8; 45 IAC 2.2-5-15; Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248 (Ind. 2003); Black's Law Dictionary 67, 989, 1535, 1587 (8th ed. 1999); Precision Erecting v. Wokurka, 638 N.E.2d 472, 473 (Ind. Ct. App. 1994).

Taxpayer protests the Department's denial of its exemption from sales and use tax.

STATEMENT OF FACTS

Taxpayer purchased an aircraft and registered the aircraft in Indiana. Taxpayer claimed an exemption from sales tax based on renting and leasing the aircraft to others. The Department of Revenue ("Department") conducted an audit review of the taxpayer. The audit denied the taxpayer's sales and use tax exemption claim and assessed tax on the aircraft purchase price. The taxpayer submitted a protest challenging the assessment. The Department held a hearing and now presents this Letter of Findings with additional facts to follow.

I. Sales and Use Tax: Exemption

DISCUSSION

The taxpayer protests the sales and use tax assessment on its aircraft purchase price. The taxpayer purchased the aircraft in August of 2003 for $1,274,610. Taxpayer contends that it purchased the aircraft to rent and lease to others as a business venture. During the course of the protest, the taxpayer provided its operating agreement, a lease agreement, flight logs, and an insurance policy to support its claim of renting and leasing to others.
However, the audit review determined that the taxpayer was not entitled to an exemption because the Department questioned whether the lease agreement was negotiated in an arms-length transaction.

A presumption exists that all tax assessments are accurate. IC 6-8.1-5-1(b).
IC 6-2.5-2-1(a) states that "[a]n excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana." IC 6-2.5-5-8 provides:

> "[t]ransactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property.

45 IAC 2.2-5-15 provides:

> (a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.
> (b) General rule. Sales of tangible personal property for resale, rental or leasing are exempt from tax if all the following conditions are satisfied:
>
> (1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent, or lease it;
> (2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and
> (3) The property is resold, rented or leased in the same form in which it was purchased.
>
> (c) Application of general rule.
>
> (1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or the leasing the property. ***This exemption does not apply to purchasers who intend to consume or use the property*** or add value to the property through the rendition of services or performance of work with respect to such property…. (emphasis added.)

The Indiana Supreme Court stated:

> It is well established that exemption statutes are strictly construed against a taxpayer so long as the intent and purpose of the Indiana Legislature is not thwarted. As such, a taxpayer has the burden of establishing its entitlement to an exemption.

Indiana Dept. of Revenue v. Interstate Warehousing, 783 N.E.2d 248, 250 (Ind. 2003).

IC 6-2.5-5-8 involves a fact intensive analysis. No one fact alone will provide conclusive evidence that a taxpayer is entitled to the IC 6-2.5-5-8 exemption. However, certain facts provided by the taxpayer may suggest whether or not the taxpayer intended to acquire property for renting and leasing in the ordinary course of its business.

Using this analysis, the first fact for consideration is the lease agreement between the taxpayer and the aircraft charter service company ("Service Company"). This agreement was initially provided to the audit review and showed that the taxpayer had entered into an "Aircraft Master Lease Agreement" for five hundred and sixty dollars ($560). The individual that signed the lease agreement for the Service Company, also served as the registered agent of the taxpayer. However, at the protest hearing, the taxpayer stated the agreement was not a lease agreement. The taxpayer stated the agreement was an agreement for pilot service. The taxpayer explained that it desired to charter its aircraft; but, the FAR §91 certificate it held did not allow it to operate as a charter or air-taxi service. To provide this type of service, the FAA requires an individual to have a FAR §135 certificate. As a result of the agreement, the taxpayer was able to charter out its aircraft through the Service Company, until it received its FAR §135 certificate a year later. The taxpayer further argued the rental rate it charged was only for usage of the aircraft, and did not include charges for fuel and pilot service. The taxpayer explained the higher rental rate the audit review used as a comparison reflects the rate charged by holders of a FAR §135 certificate, where the rate includes charges for pilot service and fuel usage. The taxpayer provided additional evidence from other companies to substantiate its argument.

The audit review was correct to question whether the lease agreement between the taxpayer and the Service Company was negotiated in an "arms-length transaction" and for a "fair market rate". An "arm's length transaction" is defined as "[a] transaction between two unrelated and unaffiliated parties." Black's Law Dictionary 1535 (8th ed. 1999). A "fair market rate" is defined as "[t]he price that a seller is willing to accept and a buyer is willing to pay on the ***open market and in an arm's length transaction.***" Black's Law Dictionary 1587 (8th ed. 1999) (emphasis added). "Open market" is defined as "[a] market in which any buyer or seller may trade and in which prices and product availability are determined by free competition." Black's Law Dictionary 989 (8th ed. 1999).

In this case, the taxpayer named the owner of the Service Company as its registered agent in Indiana. Designating a person as a registered agent creates an agency relationship. See Precision Erecting v. Wokurka, 638 N.E.2d 472, 473 (Ind. Ct. App. 1994). An "agency relationship" is defined as "[a] fiduciary relationship created by express or implied contract or by law, in which one party (the agent) may act on behalf of another party (the principal) and bind that other party by word or actions. Black's Law Dictionary 67 (8th ed. 1999). By designating the Service Company owner as its registered agent, the taxpayer created an agency relationship. This relationship gave the owner of the Service Company the ability to act on behalf of the taxpayer and bind the taxpayer, as well as, the owner's own company. By having this ability, the Service Company owner became a related party to the taxpayer. Thus, because the parties to the transactions are related, the transaction was not done at arms-length. Even more so, the transaction was not done for a "fair market rate" because the price was not set by the "open market" and in an "arm's length transaction". By including "the taxpayer has [the] sole right to determine if the aircraft is available for reservation" in its lease agreement, the taxpayer determined the availability of the aircraft and not free competition. Therefore, because the transaction was not an arm's length transaction and the transaction was not conducted on the open marker, the audit review was correct to question that the lease agreement was negotiated in an "arms-length transaction" and for a "fair market rate".

Another fact that supports the audits denial of the taxpayer's exemption claim is the flight logs. The taxpayer's flight logs indicate from August 2003 to December of 2003 the aircraft was used predominantly by the taxpayer's owner, or a company owned by the taxpayer's owner. During this period, the flight logs do not indicate any activity for chartering. The only activity indicated is the taxpayer's owner's usage. 45 IAC 2.2-5-15(c)(1) clearly states that the renting and leasing exemption does not apply to individual's that "intend to consume or use the property". It is evident from the flight logs that the taxpayer's owner intended to use the aircraft for their own use. The only time that the aircraft was available for renting and leasing usage was when the usage did not inconvenience the taxpayer's owner.

The facts indicate the taxpayer entered into a questionable lease agreement and the taxpayer's owner used the aircraft for itself. Taking these relevant facts into consideration, the taxpayer failed to establish its entitlement to the IC 6-2.5-5-8 exemption for renting and leasing to others.

FINDING

For the reasons stated above, the department denies the taxpayer's protest.

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